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SEPTEMBER 14, 1987 $3.50

FORTUNE

DO WE LIVE AS WELL AS WE USED TO?

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SEPTEMBER 14, 1987 VOL. 116, NO. 6

FORTUNE

"My parents' first house didn't even have a septic tank. The basement wasn't cement—it was dirt."

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"He is cash-flow driven and wants companies that have strong brand names. The blade business is a cash machine."

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"Just as commercial bankers are fighting to repeal Glass-Steagall, investment bankers are doing the things that got it enacted."

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"People who feel you're stepping on their turf ask, 'Who the hell is this bitch?' "

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"It's come to my attention that you'd like to throw me out of the company, and I'd like to ask you if that's true."

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"Let's go out to dinner to discuss your prospects for promotion."

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Cover: Yesterday's dream car, a 1959 Cadillac convertible, photographed for FORTUNE by Kenneth and Carl Fischer.

Korea: democracy's economic impact

■ Now that **Hyundai**, South Korea's second-largest industrial group, has agreed to recognize an independent labor union, the question becomes: Will democracy slow down the Korean economic machine? The answer is probably, but not much.

The government, fresh from its stunning decision to hold direct elections, played the unusual role of peacemaker between angry Hyundai workers and the conglomerate that had locked out 20,000 demonstrators. The surprise deal raised hopes for a quick end to walkouts that had spread from heavy industries to electronics companies and even taxi drivers.

Up to now the government had barred strikes and stifled labor unions in its pursuit of economic growth. With an average manufacturing wage of $1.75 an hour, lower than that of those other industrializing Asian tigers—Taiwan, Hong Kong, and Singapore—Korea has become the world's leading exporter of ships, shoes, and microwave ovens.

If companies grant pay increases of 10% to 15%, the Korea Development Institute, a highly regarded government research outfit in Seoul, figures that the economy would grow only 5.5% in the second half of the year, vs. 15% in the first six months of 1987. But other experts call the forecast unnecessarily gloomy. John T. Bennett, president of the Korea Economic Institute, a Washington-based research firm, thinks 10% growth in the second half is not out of the question. "The stimulus of bigger wages and victory might bring those demonstrators back all fired up," he says. "If a guy thinks he's going to get a bigger hunk of the pie, he wants a bigger pie."

The never-sleeping precedent setter

■ When **Citicorp** became the first of many big banks to put aside huge reserves against possible losses on Third World loans, taking a $2.5-billion write-down in the process, Wall Street applauded. Since the May announcement, the stock price of the largest U.S. bank has climbed from about $50 a share to $67. But when Citi struck again, saying it would replenish some of that capital with a $1-billion stock offering this fall, the stock dropped. Financial analysts worried that an equity offering could dilute the stock and hurt earnings per share. Many Citi watchers had expected the bank to rebuild capital through asset sales and retained earnings. Did an equity offering mean the bank might not meet the earnings estimates it made last spring?

More likely, John Reed, Citicorp's chairman, is just taking advantage of the market. All the companies to issue $1 billion or more of stock have done so while the five-year-old bull has raged; five of the six launched stock offerings this year or last (see chart). By floating 17 million new shares, Citicorp may glut the market, leaving most competitors—many of which also took dramatic write-downs to cover potential Third World loan losses—high and dry. Says Cheryl Swaim, banking analyst with Oppenheimer & Co., a New York investment house: "There's a question of how much bank equity the market can absorb. Citicorp was smart to move early."

Which banks might follow Citicorp this time? Not **J.P. Morgan** or **Bankers Trust**. They have healthy supplies of capital. You can also forget **Manufacturers Hanover** and **BankAmerica**. They are too hard-pressed financially to sell big stock issues now. Instead, these banks will probably rely on other methods—asset sales, for example—to raise capital. But maybe **Chase Manhattan** and **Chemical** could jump into the new-issues market. Both need money, mainly to cover loan-loss reserves. But like Citi, they are in sound enough health to attract plenty of investors.

CORPORATE ISSUER	STOCK OFFERING BILLIONS	YEAR
AT&T	$3.263	1981-83
Consolidated Rail	$1.645	1987
Henley Group	$1.190	1986
Coca-Cola Enterprises	$1.178	1986
Occidental Petroleum	$1.157	1987
Citicorp	$1.000est.	1987

SOURCE: IDD INFORMATION SERVICES

DAVID BURNETT—CONTACT

Trend-setter Reed

If the shoe fits . . .

■ Italy has long been known for its fine, fashionable footwear, the kind Americans love to buy. But now the shoe seems to be on the other foot. Trendy Italian men from Milan to Montepulciano are sporting American-made outdoor shoes like Timberlands and Sperry Topsiders, as well as casual classics from Sebago.

Barely a footnote in the trade story ten years ago, sales of American shoes to Italy jumped 23% in 1986 to 1.2 million pairs out of total U.S. exports of nine million pairs, according to Footwear Industries of America, a trade group. During the same period 65 million pairs of Italian shoes marched into the U.S. But the American niche in Italy is lucrative. The New Hampshire–based **Timberland Co.** sold

Motorcycled and menacing, workers prepare to protest against Hyundai.

SABOO TUCK—TIME

DO WE LIVE AS WELL AS WE USED TO?

Vastly better, by almost every material measure. That's true for rich and poor, black and white, old and young. Yet we pine for the good old days, when Dad supported Mom and the kids on one paycheck and the split-level cost the same as today's new car. Here's why. ■ *by Sylvia Nasar*

WE SUSPECT the grass was greener. Life sweeter. The breaks better in the golden age after World War II, when the postwar boom was on and our parents were young. But as Jackie Gleason said, "The past remembers better than it lived."

It does. The average American has never had it so good. By almost any measure of health and wealth, if not wisdom, we are demonstrably better off now than in the palmy Fifties and Sixties. And that goes for just about any group you would care to name: the middle class, the poor, baby-boomers, old people, black people, women.

In some respects, despite oil shocks, recessions, and higher inflation, the gains in the Seventies and Eighties came as fast as or faster than in the two preceding decades. Our incomes are up, and so was our net worth even before the bull market turned into a stampede. We have more opportunity—to go to college, land a good job, start a business. We can choose among more things to buy, and more important, we have more choices about how we live. Arguments to the contrary notwithstanding, inequality has diminished. In the land that stands for opportunity, we are less prisoners of economic class than we ever were before.

REPORTER ASSOCIATE *Alan Farnham*

Okay, you ask, if our purses are heavier, why aren't our hearts lighter? According to pollster Louis Harris, fewer Americans were satisfied with their economic circumstances in 1986 than in 1956. And fewer said that they were happy. One reason is that pay has been rising more slowly than during the boom times of the Sixties. Another is that higher incomes have often come at a price: More wives are working. We are also bruised from the epic battles of the Eighties—the battle with double-digit inflation, won at the price of deep recession, and the battle to make American industry more efficient and competitive, which is still producing casualties and anxiety.

In addition, we are victims of our expectations. "Kids nowadays want more than we did when we were their age," says Burdette Jenks, 65, a retired Pacific Gas & Electric troubleshooter who lives in Woodland, California. "Like a home of their own and all the latest things. They're impatient. TV was out four or five years before we bought it."

Finally, in case you might have forgotten, money does not necessarily buy happiness.

If we look back two to three decades without nostalgia, we can see striking differences in how we live. To show trends clearly, comparisons with the past in this story are generally made in dollars of equal purchasing power, adjusted for intervening inflation.

Prices have nearly quadrupled, and taxes have been taking a bigger bite since the Fifties, but the average American commands *twice* as much buying power today as in 1952. And per capita income after taxes has been rising in recent years—by a third since 1970, and by a tenth just since 1980. The rate of growth since 1970 is only about half the Sixties' pace, but it matches that of the Fifties.

THE TYPICAL AMERICAN family's income before taxes, as measured by the Census Bureau, was half again as high in 1986 as in 1960, $29,458 vs. $19,500. All types of families got richer. Compared with their counterparts in 1960, households headed by young adults in their late 20s and early 30s—the baby-boomers whose scramble to find their places in a crowded job market has inspired so much hand-wringing—earn 25% more. For women

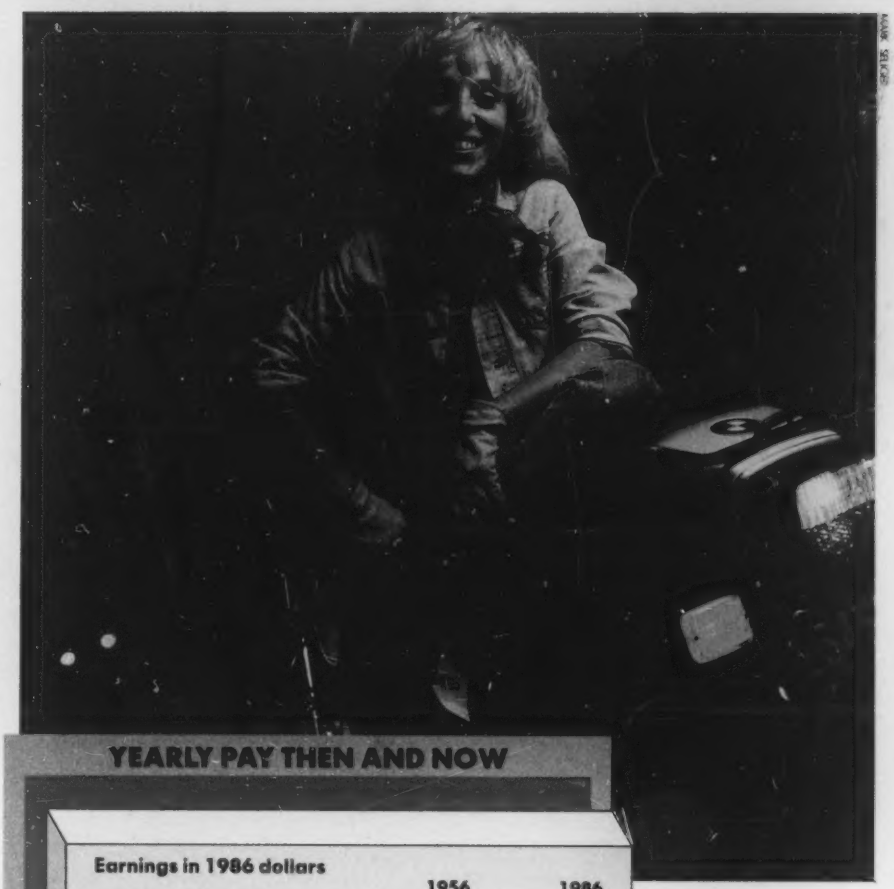
who are raising families single-handedly, the increase is 33%. Couples with two paychecks, not surprisingly, are doing best: Their incomes are up 60%. But even when the wife stays home, the sole breadwinner brings back 34% more.

The census numbers understate the rise in living standards. Families are smaller now than they were in 1960, so they have more dollars to spend on fewer folks. The mix of families has shifted since the early Seventies toward households headed by young adults and old people, who typically have lower incomes than the middle-aged. The change depressed the average. Also missing are significant gains in noncash income, which the Census Bureau doesn't count. Employee benefits like health insurance and pension funds are twice as large a share of total compensation as they were 35 years ago.

What does a 50% improvement in family incomes mean to us? According to a recent Roper poll, most Americans believe it takes an average family $20,000 to make ends meet, $30,000 to live moderately well, and $50,000 to achieve the American dream. By these yardsticks the typical family was barely getting by in the golden past but now lives in reasonable comfort. And one in five families now, vs. fewer than one in 20 then, have made the dream come true.

But wait, cry some economists, these aggregate numbers hide a widening cleavage between rich and poor. And indeed, census data suggest as much. Between 1960 and 1986, the share of total income earned by the top two-fifths of families grew, while everybody else's share declined. But the shifts have been slight. Income distribution is still about the same as it was at the end of World War II. And rather than displaying troublesome inequalities, the recent shifts--like those in income—most likely reflect changes in the mix of families.

At the same time, a family's chances of



MARK SELIGER

YEARLY PAY THEN AND NOW

Earnings in 1986 dollars	1956	1986
G.M.'s chief executive	$2,641,000	$1,425,000
All FORTUNE 500 CEOs	$402,110*	$931,800
A. T. & T. middle manager	$30,350	$41,000
Average plant manager	$75,880	$65,000
School teacher	$15,940	$25,450
Gov't. worker (state or local)	$15,210	$25,830
Private secretary	$16,390	$23,190
Service worker	$12,780	$17,643
Steel worker	$20,530	$31,360
Factory worker	$15,560	$20,600
All employees	$16,000	$19,750

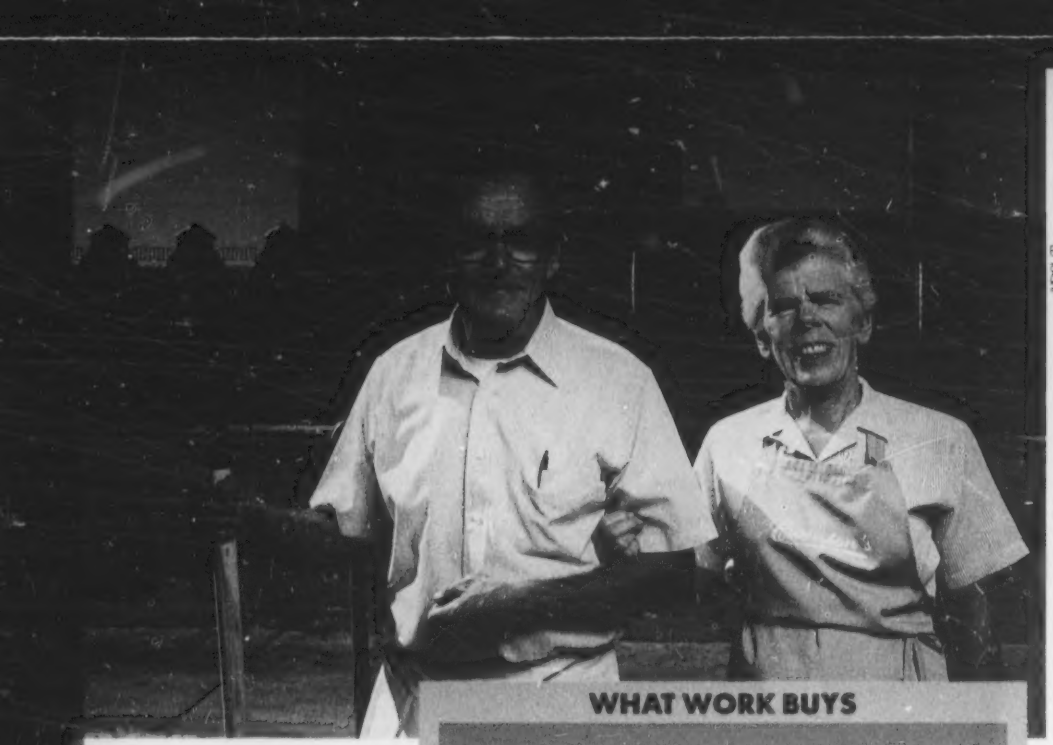
* FORTUNE estimate

CHARTS BY JOE LERTOLA

Economic Cyclist

Though she and her fellow secretaries make much more than they used to, Janet Kramer, 34, of New York says her parents' generation had better prospects. She's got big hopes, however. She plans to start her own business —a school that teaches women to ride motorcycles. Some pessimist.

KENNETH AND CARL FISCHER



B. KAY

American Classics

Nancy and Eldon Cranston of Woodland, California, both in their 60s, own a hardware store that's half bridal boutique. These purveyors of paint and crystal have prospered by selling lots of things that customers can buy with ever less work. They are looking forward to retiring in the next year or two to a dream house they're building on "the most beautiful lot on Mount Shasta that you ever saw."

WHAT WORK BUYS

	1956	1986	Percent Change
Average hourly wage in 1986 dollars (nonfarm workers)	$6.80	$8.80	30%
Work time required to buy:			
Kitchen range	125.1 Hrs.	41.4 Hrs.	-67%
Man's suit	67 Hrs.	30 Hrs.	-55%
Visit to doctor	2.3 Hrs.	3 Hrs.	30%
Car tune-up	10.4 Hrs.	9.2 Hrs.	-11%
Car insurance	33.6 Hrs.	50.3 Hrs.	50%
Gallon of paint	3.6 Hrs.	2.4 Hrs.	-33%
Six-pack of beer	39 Min.	21 Min.	-46%
Movie ticket	27 Min.	29 Min.	7%
Chicken (fryer)	15 Min.	6 Min.	-64%
Dry cleaning (1 dress)	15 Min.	6 Min.	-11%
Man's haircut	46 Min.	39 Min.	-11%

moving up the income ladder show no signs of diminishing. The Michigan Panel Study of Income Dynamics has tracked the fortunes of 5,000 representative families from 1968 to 1982. Greg J. Duncan, an economist at the University of Michigan, concludes that younger Americans' chances of trailing their predecessors by a rung or two rose slightly during the Seventies because of the crowding, but that upward mobility increased for the majority, meaning those 35 and older.

And what of the poor? The official poverty rate stopped falling in the early Seventies and rose in the early Eighties. The rate has since declined to nearly its 1980 level. But income used to calculate the rate does not include government housing subsidies and food stamps. Count these as income and only one in ten Americans is poor today, vs. one in five in 1960. More important, the Michigan Panel data show that less than 2% of Americans are permanently poor.

The great cloud in this otherwise sunny picture: The improvement in living standards since the early Seventies has come less from working smarter and more from working harder. We're also postponing or doing without many things that used to be considered essential parts of the good life: We are marrying later, having children later, and having fewer of them. Whether we're happy with these choices or not—visions of the good life change over the years—they are undeniably trade-offs. Says Brandon Balthazar, a recruiter for the Prudential in Newark, New Jersey: "At my age my parents had a kid, a house, commitments. I never thought I'd be 31 and not have kids. It surprised me."

Everybody knows that ours is a fly-now, pay-later age, and many people—consumers as well as economists—worry about our reliance on debt. "The country today is run on a credit card," says Bobby Horvath, 43, a second-generation rubber worker in Akron. "When my dad was young, he saved for it, then he bought it." Less well known is that despite our heavy-duty borrowing, the net worth of American households—assets minus liabilities—has kept growing right in line with our incomes. The average net worth per American has swelled by three-fourths since 1960.

By standard measures, the distribution of wealth, like the distribution of income, has shifted slightly toward the top since the Fifties and Sixties. The difference is "marginally statistically significant," according to Robert Avery, an economist at the Federal Reserve. But, Avery adds, if you include employees' accumulated pension rights, which normally are not part of wealth calculations, that tilt toward the top turns into a slight decline. Ed Wolfe, an economist at New York University, argues further that people's claims to future Social Security income should be taken into account. When they are, the inequality of wealth has diminished steadily since World War II.

UNEQUAL WEALTH does not seem an issue worth stewing about in any case unless it is so severe that it provokes widespread envy and anger. The swift, the clever, the lucky—and yes, some of the larcenous too—will inevitably get richer. More important are the opportunities for earning money. The total number of jobs has barely kept pace with the number of Americans who want to work. But the proportion that are "good" jobs—high-skilled, high-paid—has increased, according to Neal Rosenthal, a Bureau of Labor Statistics economist. Again in today's dollars, jobs that pay more than $45,000 a year, mostly managerial and professional, account for about 8% of all full-time, year-round positions now, vs. 3% in 1960. And the fraction of menial, low-paying jobs is smaller: 16% now vs. 21% in 1963.

Is starting out harder? Starting out was *always* hard. George Winch Jr., 32, an obstetrics resident in San Francisco, compares his situation with his father's: "Getting into resi-

THE WEALTH OF NATIONS: THE WORLD IS GETTING RICHER

■ Though Americans are living better than ever, the rest of the world is doing pretty well, too. The myopic Thomas Malthus has been proved wrong one more time. Populations do not necessarily starve themselves down to size. The planet now supports close to five billion people more comfortably than it sustained three billion in 1960. Two countries—West Germany and Japan—have made such astounding progress that the U.S. no longer has indisputably the highest standard of living among major industrialized nations.

Country-by-country comparisons are difficult. The U.S. had per capita income of $16,494 in 1985 and West Germany $10,243. This reveals something about the relative ability of Americans and Germans to buy Rolex watches and Sony stereo systems and other internationally traded items but nothing about their ability to pay for houses and haircuts, whose prices differ vastly depending on the market. To account for variation in local costs, two University of Pennsylvania economists, Alan Heston and Robert Summers, use a complicated system to compare the wealth of nations in terms of the purchasing power parity (PPP) of their citizens.

They assign the U.S. an index score of 100. By comparison, West Germany gets an 84, which means that on average Germans have 84% of the goods, including capital goods, and services, including government services, that Americans do. That's up from 40% in 1950.

But experience suggests that even the PPP adjustment does not tell the whole story. FORTUNE associate editor Louis Richman, who recently returned from three years in Frankfurt, points out that although Germans have slightly fewer cars than Americans (42 for every 100 persons vs. 48 in the U.S.), they do not need as many. Americans are more likely to live in suburbs and Germans in cities.

Americans own more clothes and boats and vacation homes, but Germans travel outside their country more and have six weeks of vacation a year in which to do it (vs. the U.S. average of 2½ weeks). A German is only half as likely to be murdered as an American. One of the few respects in which American life is clearly more agreeable is the opportunity for a second chance. A German businessman who goes bust is marked a failure for life. An American can pick himself up and try again.

The French score a respectable 79 on the PPP scale, while the British manage only 66—four points below East Germany. The Italian number is 54, and the Soviet Union ranks last among major industrial powers with a mere 47.

Japan rates a 77, a remarkable jump from 17 in 1950. In the 1960s the acquisitive dream of a Japanese family was the three C's: car, color TV, and cooler (air conditioner). Today 57% of Japanese households have air conditioners, 71% have cars, and 99% have color television sets, compared with 60%, 87%, and 88% in the U.S. Although many Japanese are still satisfied with a package tour to Honolulu, younger travelers in particular want individual jaunts, such as a trip to Malibu for skin diving.

Males born in Japan in 1985 can expect to live to 75 on average, vs. 72 for Americans. And Japanese can walk the streets of Tokyo at night and ride the subways without fear.

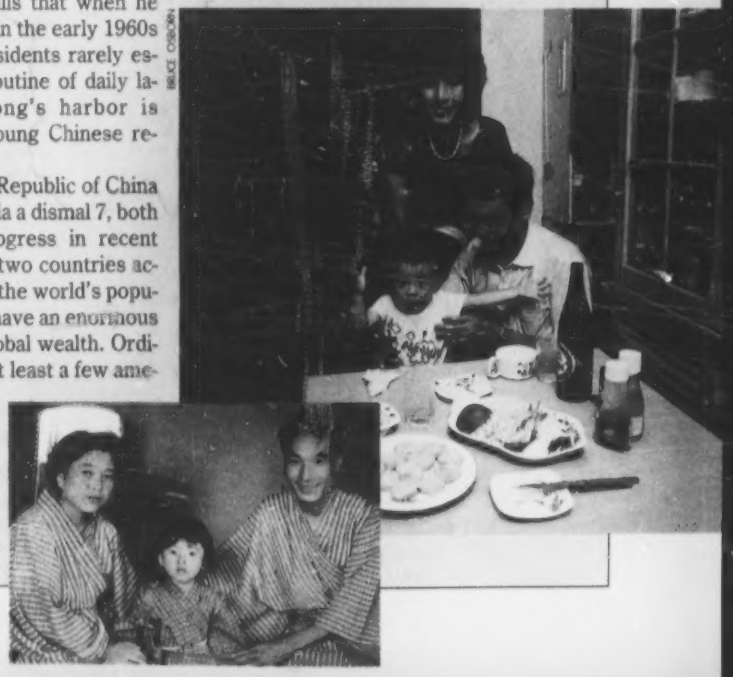
The world's most spectacular advances have come in Asia. Hong Kong (PPP 58), Singapore (46), Taiwan (36), and South Korea (31) have spawned middle classes that live in homes with electricity, telephones, and indoor plumbing. They take family vacations and send their children to college, often to the U.S. FORTUNE Asian editor Louis Kraar recalls that when he first visited Hong Kong in the early 1960s the haggard Chinese residents rarely escaped the exhausting routine of daily labor. Today Hong Kong's harbor is crowded with robust young Chinese relaxing on their yachts.

Though the People's Republic of China gets a PPP of 19 and India a dismal 7, both have made modest progress in recent years. And because the two countries account for almost 40% of the world's population, even small gains have an enormous impact on the sum of global wealth. Ordinary Indians now have at least a few amenities. "Wristwatches were rare when I first went to India 20 years ago," says Jean Baneth, a senior economist at the World Bank. "Now they are common, and so are transistor radios."

Latin American nations boosted their living standards considerably through the Sixties and Seventies on money borrowed from the U.S., Western Europe, and Japan. Now the debt crunch is pushing them backward. A generation ago Argentina seemed close to a standard of living comparable to the best of the West. But Argentina's per capita GNP grew at a paltry 0.2% a year from 1965 to 1985, compared with 1.7% for the U.S. and 4.7% for Japan. Argentina's PPP: only 30.

Sadly, a few countries, especially in central Africa, seem worse off. Michael Schatzberg, an associate professor of African studies at Johns Hopkins, says that when Belgium granted independence to Zaire in 1960, the typical peasant farmer could feed his family and sell enough cassava to buy such rudimentary luxuries as a flashlight and batteries and some primary schooling for his children. Since then, Schatzberg says, repressive governments have driven down crop prices so far that many farmers have withdrawn from the cash economy and simply subsist. Zaire has a feeble PPP of 2.5. While the world may be a better place, it is not yet altogether good. — **Lee Smith**

Japan's leap: *When Kuniko Kanemaki was 2 (inset, with parents in 1957), times were lean. Now she and her family live, if not like kings, much like Americans.*

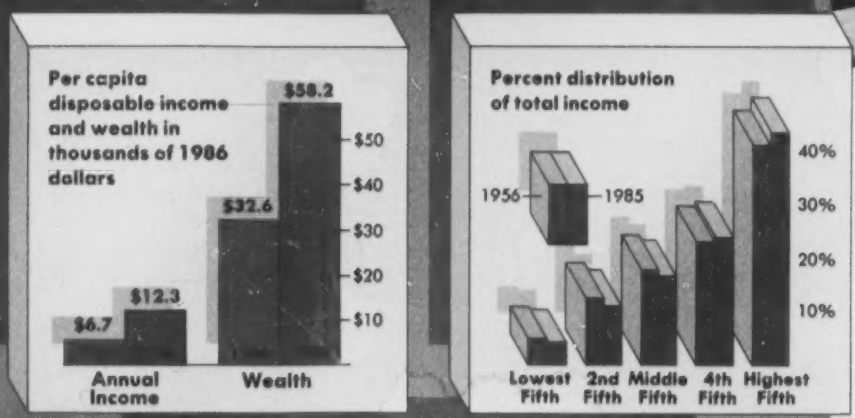


The Elite Expands

The growing totals of income and wealth are being shared by a greater diversity of people. "There are many more doors open to me," says Brandon Balthazar, 31, of Montclair, New Jersey (far right). A campus recruiter for the Prudential, Balthazar has breakfast here with two recent recruits. The black elite, to which both he and his parents belong, has grown sixfold in the past decade and a half. And the black middle class is a solid majority.

ANDY FREEBERG

INCOME AND WEALTH



Average household wealth in 1986 dollars

	1963	1983	Percent Change
Top 10%	$832,190	$977,350	17%
Bottom 90%	$33,410	$51,120	53%

dency programs is much, much tougher now. But just as I spent a couple of years working at the Indian Health Service to repay my medical school loans before I could get on with my residency, dad spent a couple of years out in World War II and Korea. So he was about 34 when he went into private practice. Residents got practically no pay then. After my older sister, Jennifer, was born, Grandma came to babysit, and Mom had to go out and get a job. I'd say that's pretty comparable."

In some ways American well-being has increased much faster than plain buying power. The first wealth, wrote Ralph Waldo Emerson, is health. We can expect to live five years longer than we could in 1960. Infant mortality, which plateaued during the Sixties, fell by one-half during the Seventies and Eighties. Fewer adults die of heart disease or in accidents on the road or on the job. Whites live longer than blacks on average, but the gap in life expectancy, six years, is two years smaller than it was in 1960.

Some Americans who are living longer are merely vegetating in nursing homes—more is not always better. There are new diseases, of which AIDS is the most devastating. The U.S. has long trailed the Scandinavian countries and Switzerland in infant mortality rates and longevity; recently it has been surpassed by several others, including West Germany, Japan, and Spain. But blame the Statue of Liberty in part. Those countries don't admit waves of immigrants, many of whom arrive impoverished, malnourished, and with short life expectancies. On the whole, by Emerson's yardstick, Americans are richer now than ever before.

MEDICAL CARE COSTS have soared, but many more Americans can get care when they need it. That's mostly because of the advent of Medicare and Medicaid in the mid-Sixties, as well as a widening umbrella of private insurance plans. Fully 85% of Americans now have some form of coverage, vs. 70% in 1962. Poor Americans have made the biggest gains, according to Christopher Jencks, a sociologist at Northwestern University. More than two-thirds had some kind of health care coverage last year, vs. a third in 1960. Geography is also less of a barrier to good care. Because the medical schools turned out bumper crops of graduates in the late Seventies, says Steven Rosenberg, a professor of public health at Columbia University, young M.D.s have started to fan out to small towns that have been short of practitioners for decades.

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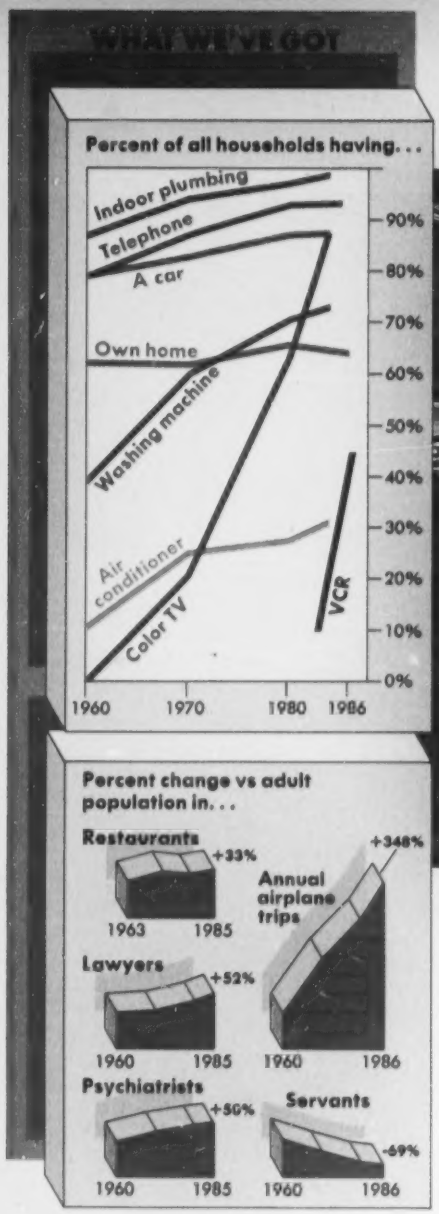


EGEN PROBST

When Enough Is Enough

The grass is plenty green for trucker Kevin Stephens, 39, and his family in Del Rio, Texas, here amid a few of their belongings. Not in the picture: his other two houses. Says he, "Ten or 15 years ago, getting material things posed such a large mountain for me to overcome. They blocked out everything else. After I got them, it was time to move on to something else. Like Rodney Dangerfield says, you want respect."

Americans eat more, even though they spend less of their budgets on food than ever before. The 10% rise in the calories we consume isn't necessarily a sign that we are living better, since more of us die from overeating than from its reverse. But we have also been upgrading our diets since at least 1970. We eat more fish, chicken, and fresh vegetables, more fruit, less cholesterol-filled red meat, and fewer fat-laden dairy products. Though some of the poor still go hungry, the patterns of food consumption by the poor and the affluent had converged by the late Seventies, mostly because of the food stamp program.

Nothing contributes more to middle-class malaise than signs that the staples of the good life—a new car, a house, a college education—are being priced out of reach. "You have to work harder and longer to get the same stuff," says Janet Kramer, 34, an executive secretary in New York City. "My mother-in-law was always telling me about the $1 deposit they put down for their first house." Indeed, when you look at prices *without* adjusting for inflation, the comparisons are stunning. The average set of wheels last year came with a sticker price close to $13,000—five times higher than in 1960. A 1986 Honda Accord costs as much as a suburban ranch house did in those days. (So, for that matter, does a year at Notre Dame.)

But it takes the average family 23 weeks of income to buy that median car now, vs. 26 weeks in 1960, and it's hardly the same car. The average 1960 Ford, Plymouth, or Chevy, though alluringly mauve or even cerise, had no power steering, no power windows, no stereo tape deck, and no air conditioning. It burned more gas. Handling and braking were atrocious by today's standards. Other safety features and pollution controls weren't part of the package, as witnessed by the scarifying death rate and sooty air of 30 years ago. And choices were among species of Detroit iron distinguished mainly by chrome, tonnage, and finnage—not exactly the vehicles for self-expression encompassed by the present variety of minivans, jeeps, and imports of all types. Even today's $6,000 entry-level car—say an Omni America or Hyundai—is better in most functional ways than the 1956 Cadillac, and it costs just 11 weeks of the average family's income.

AS A RESULT, Americans own more cars. The two- and three-car family—a relative rarity in what was supposedly the great age of the automobile—has squeaked over the 50% line in the post-OPEC Eighties. Fewer than one in ten households has no car today, vs. one in five in 1960. And we acquire them when we are younger. George Golomb, 40, a Baltimore lawyer who got his first car—a red MG—at age 22, remembers when his parents got theirs: "They were 36 and 37. It was a Chevy. I don't remember the model—just that it was very exciting."

Houses, on the other hand, *are* less affordable. The typical used house—the kind first-time buyers buy—cost $83,000 last year. The median family had to fork over an

$18,000 down payment, $1,725 in closing costs, and 24% of its income every month to call a median-priced home its own. Not surprisingly, the ownership rate for boomers in their early 30s has dropped five percentage points, to 55%, in the Eighties.

But the recent decline isn't as scary as it seems. Housing is no longer as appealing an investment as it was in the Seventies, when it was "a super Christmas club," as George Sternlieb, a housing expert at Rutgers University, puts it. A longer-term perspective helps too. More Americans own their own homes than they did in the Sixties, when ownership barely increased. Prices still bear about the same relation to family income, 3 to 1, that they did in the late Fifties. Monthly carrying costs are higher, but not that much higher than in the mid-Seventies when almost everyone who could buy did. Experts agree that home ownership rates are bottoming out now and should resume their gradual rise.

Most young buyers have forgotten how long it took their parents to land their first house. "We lived with my parents first, then her parents; then we rented Grandmother's house," recalls Burdette Jenks, the retired troubleshooter. Says Nancy Rodgers, 40, who runs a dairy farm in Vermont with her husband, Jim: "When we started out, most people in this area didn't buy a home right away. They rented a furnished apartment. They built up their savings. Now they start out with everything, and it's rough to keep up. I know there was financial pressure before, but people weren't thinking as big."

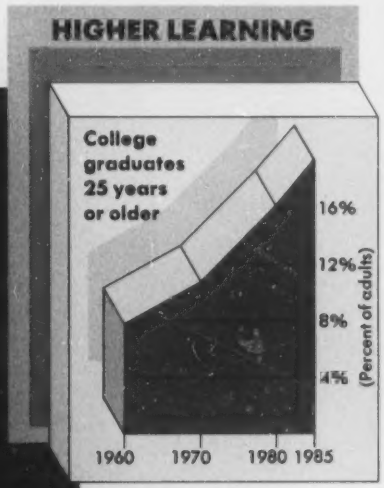
INDEED they weren't. Most boomers wouldn't be caught dead in their parents' first nest. Those Levittown dream houses were exactly half the size of today's new homes, and young families were a lot bigger. Building codes weren't what they are. The nearest equivalent today, quite literally, is a mobile home—the typical price of which is about half that of a Levittown econobox, not including its tiny plot of land. Says Bobby Horvath, the Akron rubber worker: "My parents' first house didn't even have a septic tank. We put the septic in ourselves. The basement wasn't cement—it was dirt." Bobby's first house was a 1½-story Cape with, he says, "all the modern conveniences."

Many young Americans, unwilling to settle for a tract house, much less a mobile home, would rather rent. The average apartment today is newer, more spacious, and more stuffed with amenities than in 1960. Even people who have little choice about where they live and no chance of home ownership are better off. Many ghettos have become conspicuously more wretched places, but most poor people's housing conditions have improved markedly. Mainly because of federal rent subsidies and a construction boom in the Seventies, the fraction of Americans who live in old and dilapidated buildings has dropped since 1960.

Remark at a party that the middle class is being priced out of a college education, and you can expect a chorus of assent. College bills have outpaced inflation since the Fifties, but never by a wider margin than during the past few years. Sending a freshman off to a four-year private college last fall took a cool ten grand. The 1960 father laid out only $1,600 (unadjusted for inflation).

So how is it that college enrollment is at an all-time high? One-half of young adults spend at least some time within the ivy walls, compared with one in four during the Fifties. Answer: Private colleges turn out only about

ANDY FREEBERG



Father Knows the Best Is Yet to Come

Bobby Horvath, 43, of Akron is a second-generation rubber worker with a high school degree. His daughter Kelly is off to college this fall. Says Horvath: "When you got four kids, you're trying to give them something that maybe you didn't have when you were growing up. Education is everything now."

20% of the country's graduates. The families of the remaining 80% send their kids off to heavily subsidized public colleges. Their bills are only half those of the private-school crowd—and have actually declined slightly as a share of the income of families with college-age children.

The explosion in financial aid for college students also lets many attend who could not in the past. Says Christopher Jencks: "If you couldn't afford college in the Fifties, nobody would lend you money except Uncle Harry, if you had one." Now about half of all freshmen get loans, grants, or work-study jobs on campus, vs. 4% in 1960.

Some of the biggest gains in living standards have come for those who started out the furthest behind. Back in those golden Fifties, most Americans did not notice or care that one-third of the elderly and one-half of black people were destitute. Economic independence for women was not an idea to be taken seriously.

THE OLD in America today work less and live longer, and at the same time they are wealthier and more independent than ever before. Their median per capita income, now higher than that of the average American, has doubled since 1960. Social Security benefits and private pensions have soared. Today's elderly have piled up assets like no generation of oldsters in history: Though they account for just one-sixth of the population, they hold title to one-third of all household net worth and 40% of all financial assets. Fewer than one in ten people over 65 are poor.

As a result the elderly are less likely to be burdens for their offspring—whose living standards are thus improved in ways the statistics fail to capture. Fewer than 10% live with their children, vs. more than 30% in 1950. "I was the Social Security of my parents," says Buddy Mintz, a 76-year-old retired piano salesman in North Miami Beach, Florida. "God forbid my children should have to take care of us. The big difference is that my parents had nothing after the Crash. I maintained the family. When my brother and sister got through school, they got jobs and took over."

Today it's more likely that parents and grandparents are helping the kids. In the early Eighties about one-third of first-time home buyers got part of their down payments from relatives, up from about one-tenth in the late Seventies and who knows what tiny fraction in earlier decades. Jon and Ginny Goldsmith, a Chicago couple in their early 30s, got help from Ginny's parents to buy and renovate the three-story apartment building they live in. The couple earns about $30,000 a year, or more than half their income, from their rental property, which includes two other buildings they recently bought with their own cash. Says Ginny: "We took the money my parents gave us and made it worth more."

Barely 20 years ago, after riots swept Detroit, Watts, and ghettos in a dozen other cities, the Kerner Commission report opened with portentous words: "Our nation is moving toward two societies, one black, one white—separate and unequal." It didn't happen that way. Instead most blacks have joined the middle class. More than three-fourths of black men now earn middle-class incomes or better, according to James Smith, senior economist at the Rand Corp. In 1960, 40% of black women were still working as domestics or agricultural laborers, vs. 5% today. And the gap between the earnings of black and white women has nearly disappeared.

> Back in those golden Fifties, most Americans did not notice or care that one-third of the elderly and one-half of black people were destitute.

"I'm optimistic. Very optimistic," says Easter Green Stewart, 37, a data-processing clerk in Harlem. Her grandmother was a domestic, her mother has been working in a leather-goods factory for the past 30 years. Says Stewart: "She stands up all day, and she hasn't taken more than a day or two off in the last two years. Mother works so hard . . . and she has nothing." Stewart and her husband, who works in a program that shelters homeless men, have recently bought a piece of land outside Atlanta. They hope to move there and build a house in three or four years.

The black elite has grown even faster than the black middle class. About 15% of black men make more than the average middle-class white, and the proportion is rising. Until fairly recently, most black college graduates went into government. Now they are heading for private industry, where the big money is. The most dramatic exemplar of this new generation is Reginald Lewis, who recently bought a huge hunk of Beatrice Cos. and became the country's top black businessman (see Fortune People).

A growing proportion were raised by parents who themselves were of the elite. Brandon Balthazar is the son of two professionals who collected art and vacationed in Europe. A Harvard graduate, Balthazar earns well over $50,000 a year. His top-notch education—and the excellent contacts he made at prep school and college—has given him better opportunities than his parents had. Says he: "There will be even fewer obstacles for my kids. We'll be talking about three generations of college-educated blacks."

The lot of women has changed as much as that of blacks in many ways. The proportion who work is only part of the story—66% hold jobs today, but few remember that a surprising 40% did in 1960. More important is the change in expectations women have of themselves. Some of the newcomers to the labor force are doubtless working because their husbands cannot earn enough. At least as many, and probably more, look at work or a career as imperative in its own right. For many it is a source of power and self-esteem, a worthwhile trade-off for delaying childbearing, and a welcome complement to motherhood afterward.

SINCE 1960 work has become more rewarding. Significant numbers of women have broken into high-paying, formerly male preserves. About 14% of police officers (vs. 6% in 1960) and 18% of lawyers (vs. 2% in 1960) are women—to cite just two examples. More than a third of all MBAs last year were granted to women. As younger women arrive at the workplace with more credentials—and older ones acquire seniority and experience—women are getting more of the pay. Younger women now earn 75% as much as their male counterparts, vs. 67% in 1960.

Yet there remains disappointment amid plenty. Ask a typical boomer whether he is living better than his parents, and the answer is likely to be, "My head says yes, but my heart says no."

The head and heart are both right. At each rung of the ladder, the boomers can buy more and have a greater variety of choices than their elders. But their parents did move up the ladder faster than these kids, whose sheer numbers have depressed pay levels since they entered the work force. And freedom of choice can impose its own burdens. In the dual-career couple, who will care for the children? Whose aspirations will take the beating when the upward path calls one person to another city?

continued

The quality of life seems often not to be what it was in those simpler and less crowded times. The electronic media that expand our knowledge also immerse us in the world's woes. Our many cars pollute less, but they lodge us in monster traffic jams. We fly more, but in mounting discomfort. We dwell on crime, drug use, and other social ills that seem more menacing than ever.

Mostly, though, we suffer from an acute variant on the timeless theme of high expectations. The reach that exceeds the grasp has always earmarked the American middle class. Sinclair Lewis's Babbitt "feels at once triumphantly wealthy and perilously poor." Wealthy when he eyes his income ("eight thousand good hard iron dollars. Gee that's not so bad"), poor when he contemplates the rising claims on it ("But—Way expenses are—Family wasting gasoline and always dressed like millionaires").

That we are living better, says Amitai Etzioni, a sociologist at George Washington University, is "both true and immaterial if we don't have a criterion by which the cup is full." Boomers are less likely than their parents to feel that enough is enough. Adults in the Fifties did much better than they had been led to expect while growing up during the Depression. Result: A little more felt like a lot. Says Nancy Cranston, 60, who runs a hardware store in Woodland, California, with her husband, Eldon, 62: "When I had my two kids, I didn't buy underwear. Birthdays and Christmas, my parents would give us money, and I'd spend it at the grocery store. Maybe we were just too dumb to know better, but we enjoyed every minute of our life." The boomers, on the other hand, grew up during the Fifties and Sixties with great expectations. When they flooded into the labor market during the Seventies, reality proved harsher than anticipated. Much more feels like a lot less.

Also not to be ignored are the larger uncertainties that nibble at the periphery of our consciousness. Even during the Cold War the world seemed a less threatening place: We knew we were the earth's greatest industrial power, and we knew who our enemies were—and why. We thought we could do it all. Now we sometimes wonder if we can do it at all.

So it's not the best of all possible worlds. Yet optimism—like high expectations—remains one of our durable characteristics. More than three-fourths of young Americans believe opportunity is greater now than a generation ago, according to a 1986 Conference Board poll. A recent Roper poll reports that a similar proportion rate their chances of achieving the American Dream as excellent.

Ron Gazija, 29, of Chicago is among them. His father, who emigrated from Yugoslavia, improved his life dramatically, and the son expects to do better yet. "When dad was my age, he worked 40 hours a week in a hot place," says Ron. "I work, and sometimes more than 40 hours, but my work is different. I have freedom. I do this for myself." Ron's father was a machinist. With dad's help, Ron is a self-employed electrician. "He hustled," Ron recalls of his father. "He helped me get jobs so I'd learn the trade. He wanted to make sure I didn't sit in that factory."

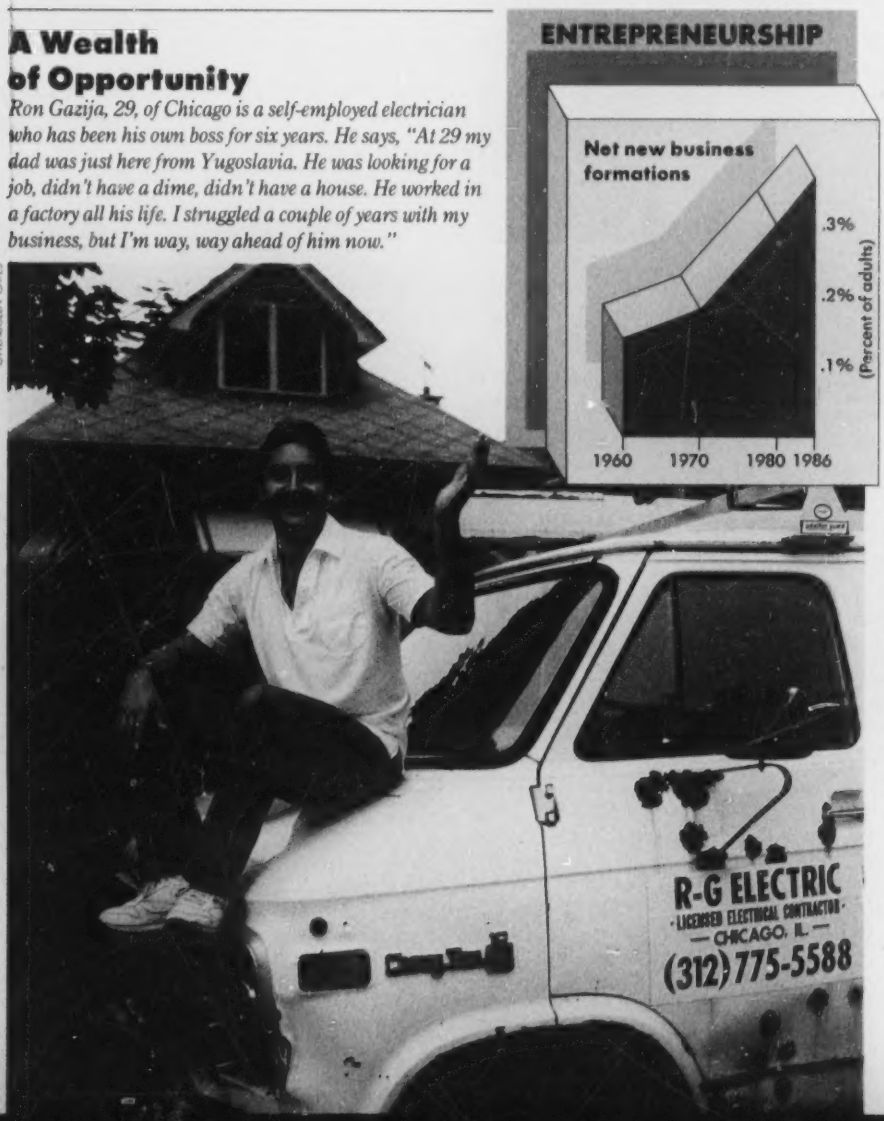
OPTIMISM and determination alone will not guarantee a continuing rise in living standards for Gazija and the other young Americans who have 30 to 50 years of work ahead of them. We have largely managed to escape the consequences of slower productivity growth by working more, having smaller families, and, in the Eighties, borrowing from abroad to boost consumption at home. We cannot live beyond our means forever. We may like smaller families, but we won't be happy if our prospects for a better life depend exclusively on greater and greater toil.

That leaves us with a tall order: Raise the growth rate of productivity. That goal has eluded us for 15 years, but the prospects have lately improved. Boomers have gotten older and more experienced. And the corporate drive for greater efficiency is well under way. Two percent a year, twice the trend of the recent past, is the magic number; it's the average for the last 100 years. It sounds less than speedy, but if we reach it our living standards would double yet again by the year 2025, give or take a year or two.

Not bad. ■

A Wealth of Opportunity

Ron Gazija, 29, of Chicago is a self-employed electrician who has been his own boss for six years. He says, "At 29 my dad was just here from Yugoslavia. He was looking for a job, didn't have a dime, didn't have a house. He worked in a factory all his life. I struggled a couple of years with my business, but I'm way, way ahead of him now."



GWENDOLEN CATES

UPHEAVAL AHEAD ON WALL STREET

After five sunny years, the investment banks are headed for gloomy times. Profitability has been zapped and the firms are taking big risks to keep earnings up. ■ *by Robert E. Norton*

AS THE DOW JONES industrial average spiraled to record highs in July and August, its ascent was eerily mirrored by that of a book called *The Great Depression of 1990,* which shot to No. 3 on the *New York Times* best-seller list—the nonfiction one. Written by a hitherto obscure economist at Southern Methodist University, Ravi Batra, the book warns of an inevitable social and economic cycle that is about to destroy the world, financially speaking, as we know it. It is prominently displayed in the bookshops of New York's financial district, and aptly so: While most readers will reject Batra's conclusions, the parallels he draws between the excesses of the Twenties and the Eighties are haunting, and no set of institutions has been gorging more greedily than Wall Street's big investment banks.

Wall Street has been an investment banker's paradise for five years. A bull market in stocks, a bull market in bonds, low inflation, easy money, and a superheated market for mergers and acquisitions—all blossomed simultaneously. But while revenues boomed at the big investment banks, expenses grew even faster, with the startling effect, shown in the chart on the opposite page, that profitability has steadily declined. The stocks of virtually all big securities firms are trading, relative to the market, at their lowest levels since 1982.

As profit margins have narrowed, Wall Street firms have been moving into riskier and more lucrative businesses, such as lending their own funds to finance takeovers. At the same time, managers are admitting that the industry's growth has outstripped their ability to manage it. The implication is clear. Even if the markets and the economy continue to bustle, the securities industry is headed for a shakeout.

In the gold rush atmosphere of recent years, big old investment banks like Salomon, Morgan Stanley, First Boston, and Goldman Sachs have grown as fast as startup companies in a hot new industry. The number of employees at Salomon, for instance, jumped 40% last year. Compensation costs for the 11 largest investment banks went up 40% in 1986, while revenues increased 26%.

Full-line brokerage houses such as Merrill Lynch, Shearson Lehman Bros., and Prudential-Bache have many more employees, most of them engaged in retail stockbrokerage operations. But since 1984, when retail business slowed and its profitability skidded, those firms have been pushing aggressively into the domain of the investment banks, launching a ferocious bidding war for new recruits and experienced specialists. The brightest MBA graduates now command base salaries of $75,000 a year and can double that with bonuses. For investment bankers or traders with a few years' experience, compensation packages in the mid six figures are commonplace and $1 million a year is possible.

Senior Wall Street managers know this growth is unsustainable but can't seem to do much about it. Industry graybeards privately cheered when John H. Gutfreund (pronounced Goodfriend), Salomon's chief executive, began publicly questioning the expense trends in the securities business last fall. But the big players are still dangling $300,000 pay *hikes* to lure 28-year-olds from one another. An executive at a big firm speaks for them all: "Pay scales in the business are absurd. But you can't cut them in an environment where the competition is prepared to maintain them."

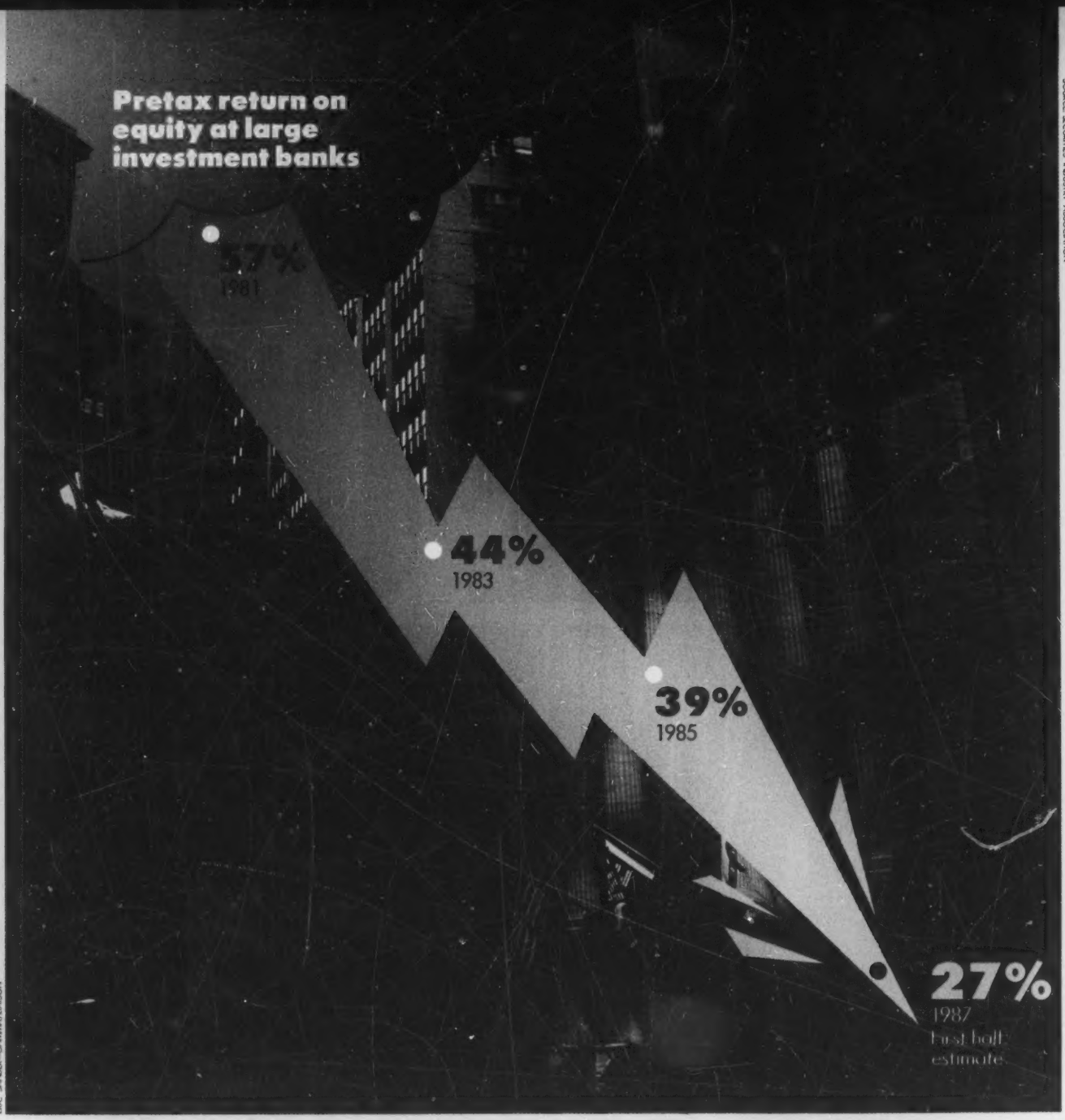
Hiring has slowed this year, but only to an average increase of 20% or so. And those percentage gains, it should be noted, are on top of the swollen staffs that built up over the last few years. At First Boston, limiting growth to 20% this year means 900 new employees—a number equal to half the firm's personnel in 1982.

Wall Street's expansion also has been fueled by the increasing "globalization" of financial markets. The growth of the Euromarkets had drawn investment bankers to London years ago, but the deregulation of Britain's capital markets last fall and the beginnings of deregulation in Tokyo have sent them scrambling, checkbooks ready, to stake out new turf. First Boston's Euromarket affiliate and Morgan Stanley, for instance, have signed up for half a million square feet of office space in London—roughly a quarter of the space in the Empire State Building. Salomon last year earmarked $300 million in capital for its Tokyo subsidiary, making it the city's fifth-highest-capitalized securities dealer, right behind Japan's big four. These operations are expensive. Keeping a security analyst in Tokyo costs at least twice the inflated salary he or she earns in New York, and investment bankers admit that profits in these new markets are years away.

ONE OF THE boomingest businesses is Wall Street's latest fad: what has come to be called merchant banking. The term is borrowed from Europe, where it describes investment banks, unfettered by regulation, that do everything from accepting deposits to buying and selling companies. On Wall Street, merchant banking most often means using the firm's own capital to finance takeovers and leveraged buyouts. Several Wall Street firms began doing this in a small way in the early Eighties, but the business went supersonic only last year.

This was partly a reaction to competitive pressure. As the pace of leveraged buyouts and hostile takeovers quickened, the speed with which deals could be financed became more important. That gave Drexel Burnham

REPORTER ASSOCIATE *Lori Lesser*



Lambert a mighty edge. With its unmatched network of junk bond investors, Drexel could assure virtually any client that it could raise the money to finance a deal, and that assurance alone often was enough to allow deals to proceed. Other investment banks responded by simply lending their own capital directly to raiders or investor groups in what is called a bridge loan. The raider repays the loan by issuing junk bonds or other securities after the acquisition is complete. Within the past year, bridge loans became a very big business (see table).

The investment bankers earn enormous fees for putting their capital at risk. In one stillborn deal last year, Merrill Lynch stood to make as much as $200 million by agreeing to provide $1.9 billion to Sir James Goldsmith for his aborted run at Goodyear Tire & Rubber. Fees approaching $100 million are becoming commonplace. These include charges for investment advice, an interest rate on the bridge loan of about five percentage points over the prime rate, and commissions for underwriting the securities that pay off the loan. But the big fees reflect equally big risks, the most obvious being that the investment bank making a bridge loan will be unable to arrange permanent financing for the borrower.

Storm Signals for Investment Bankers

Riskier than most businesses, investment banking also used to be much more profitable. But as expenses have grown unchecked during the bull market, profitability has plunged.

By getting directly involved in deals and no longer acting solely as middlemen, investment bankers also have been playing a role that has been perceived as improper for more than 50 years, ever since Congress

SIZE OF BRIDGE LOAN in millions	INVESTMENT BANK	BORROWER AND DEAL	DATE OF LOAN	STATUS OF REFINANCING
$985	First Boston	Harcourt Brace Jovanovich Inc. recapitalization	7/23/87	Pending
$976	First Boston	Union Carbide Corp. restructuring	12/08/86	Completed in March with common stock and debt offering
$917	Morgan Stanley	Management and Morgan Stanley LBO of Burlington Industries	5/24/87	Pending
$865	First Boston	Campeau Corp. hostile takeover of Allied Stores	10/31/86	Completed in March with debt offering
$800	Drexel Burnham	Carl Icahn acquisition of TWA	7/22/87	Pending
$796	Drexel Burnham	Management LBO of Hospital Corp. of America	5/31/87	Pending
$705	Merrill Lynch	Management and Merrill Lynch LBO of Borg-Warner	5/18/87	Completed in July with debt offering

The Biggest Bridges on Wall Street

Bridge loans to finance takeovers and LBOs put an investment bank's own capital at risk. They are Wall Street's latest fad and, so far, its most remunerative. But like all bridges, they could collapse.

passed the Glass-Steagall Act separating investment banking and commercial banking. As one takeover expert says of the bridge-loan craze: "Just as commercial bankers are fighting to get Glass-Steagall repealed, investment bankers are doing the kinds of things that got it enacted in the first place."

The outlook for conventional investment banking activities has already turned cloudy, even as the sun shines so brightly on the stock market. The restructuring of corporate America has transformed mergers and acquisitions, once an investment banking backwater, into Wall Street's biggest business. M&A fees account for one-quarter to one-half the revenues at most big firms and provide the cash that allows them to spend so freely in virtually all areas. The total dollar value of M&A deals announced last year was $173 billion, the third straight $100-billion-plus year. The dollar value of deals rose another 18% in the first half of 1987, according to W.T. Grimm & Co., a Chicago firm that tracks them. But the number of deals announced in the first half was down 39% from a year before, and many experts are predicting that the new tax law, the insider trading scandals, and lofty stock prices will combine to choke off the takeover boom. Any significant decline in M&A fees would clobber the investment banks' income statements.

Nearly a third of investment banking revenues, on average, come from securities trading, and profits in this business are looking even more uncertain. Profit margins on securities trades have steadily declined. An order for $10 million of U.S. Treasury bonds or notes that might have yielded revenues of $12,500 in 1982 now yields about $3,125. The dealers have been making up the difference on volume. Annual trading volume at both Salomon and First Boston, for example, exceeded $4 trillion last year, twice as much as three years ago.

THE WILD BOND MARKET swing in April revealed just how dicey this business can be. Worries about a falling dollar and higher inflation caused foreign investors (mostly Japanese) to pull back from the bond market, and prices dropped 10% in just a few weeks. Result: Investment banks swallowed ulcer-inducing losses on their trading inventories. The biggest loss—$377 million—hit Merrill Lynch when it couldn't unload a hoard of a volatile new variety of mortgage-backed securities. To put that number in perspective, Merrill Lynch's annual pretax earnings have exceeded $377 million in only one of the past three years. A $100-million mistake in Treasury bill options wiped out second-quarter profits at First Boston. At Salomon, the traders' trader, profits plunged by two-thirds, due mostly to trading losses and to revenue lost as volume shrank following the price collapse.

Profitability has also dwindled in securities underwriting, the traditional bedrock of investment banking. The fee charged for underwriting a straightforward offering of corporate bonds, for instance, had been about $8.75 per $1,000 up until the early Eighties. It has since dropped by about a third. Here the event that brought the change was deregulatory: the advent of so-called shelf registration in 1982, which streamlined the procedures for registering and offering new issues of stocks and bonds. Before the change, investment bankers negotiated a fee with an issuing company, lined up a syndicate of other investment banks to place the securities with investors, and sold the offering when the issuer was happy with the market price. Now, a company merely announces that it wants to sell a given amount of securities and puts them "on the shelf." Then individual investment banks bid for the entire issue, without spreading the risk among a syndicate, and gamble that they can resell the securities at a higher price.

With expenses soaring, risks increasing, and revenues uncertain, the stock market's bearish assessment of the investment banks seems well founded. "There's no reason to think things won't continue to deteriorate for the investment banks in the long term," says Brenda McCoy, a security analyst at Paine Webber. Flat markets and a decline in merger and acquisition activity, she estimates, could cut profits at the big investment firms by 30% to 40%.

Bridge loans could turn into a mine field. Some investment banks have lent nearly as much as their entire stockholders' equity to a single borrower. Says a commercial banker: "They're breaking a cardinal rule of commercial lending, concentration of risk. No one breaks that rule for long with impunity." Says Felix Rohatyn of Lazard Frères: "The deals done so far have been conceptually brilliant, and have worked out. But what inevitably happens is that the capital commitments will get larger, the risks will get larger, and the margins smaller. Someone will get hung up somewhere along the line."

And there is reason to believe that the kind of volatility that rocked the bond market in April could continue or even worsen. Imagine the effect on today's jittery markets of, say, the crash of Tokyo's highflying stock

market or the failure of a major financial institution. Henry Kaufman, Salomon's director of research, notes that nothing dramatic caused April's volatility, merely a heightening of inflation expectations, weakness of the dollar, and a modest firming in U.S. monetary policy. "These were not extraordinary events," he says. "I strongly believe that there are going to be far greater swings in the future, and these swings pose unquantifiable risks to participants in the market."

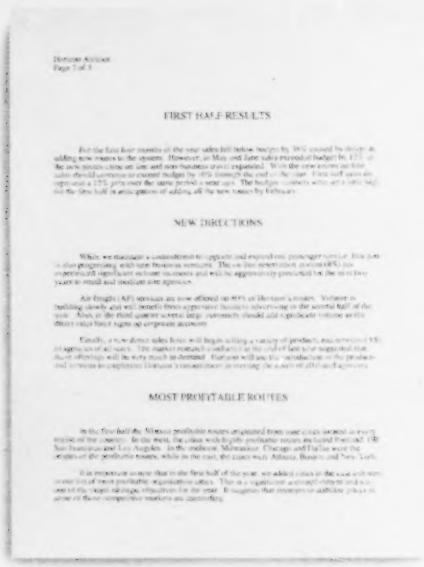
Kaufman is skeptical about junk bonds and bridge loans as well, and although Salomon has gotten into merchant banking much more cautiously than some of its rivals, his bearish views are unwelcome inside the firm. Kaufman resigned from Salomon's board last fall, feeling he no longer had enough influence on the firm's policies. Says Kaufman on the future of the industry: "There will always be an effort made to go to the next frontier of finance, where the returns tend to be higher. That can be successful, but there's a no man's land out there in that new frontier, where there are risks that may be greater than an investment banker or any banker should undertake."

Though few forecasters predict sharply higher inflation soon, if it were to come it could flatten the investment banks. "The people and systems that have built up so fast are very sensitive to inflation, so those costs would accelerate," says Samuel L. Hayes III, a finance professor at the Harvard Business School. At the same time these costs were increasing, Hayes says, rising interest rates would shrink the value of the investment banks' bond portfolios. Peter Cohen, chief executive of Shearson Lehman Bros., counts inflation as a major concern, and in the best Wall Street tradition of putting his money where his mouth is, Cohen may buy a sizable equity position in the oil business to hedge the risk.

OTHER WALL STREET executives are just as worried. The effort to rein in the growth in head count is one proof; another is a new hesitancy on the part of the investment banks to sign up for additional office space. There has been much managerial soul-searching. After Salomon's profits slumped last fall, Gutfreund put through a radical reorganization, naming the company's first chief financial officer ever. Merrill Lynch has hired professional managers from outside the brokerage industry, most notably Courtney F. Jones, former treasurer of General Motors.

The shakeout is already under way in London. The Euromarkets last year were hit by the same kind of trading turmoil that struck New York in April. The market for one of the more popular securities, floating rate notes, dried up last winter because of excess supply, and prices plunged. Dealers suspect that many investment bankers absorbed sizable losses. What's more, deregulation has made the competition in underwriting and trading downright frantic. In London's government bond market, the number of dealers went from seven to 27 last fall. Two big British commercial banks have already quit trading, and market participants say no one is making money. In July, Shearson Lehman announced it was rethinking its London strategy, amid rumors that the company would lay off up to a third of its 1,400 London employ-

Maybe it's not what you're saying that's so dull.



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ees. A year ago the number was 900. The compensation packages demanded by bond traders, reports an American bank, have dropped by about 25% in the past month.

Unsurprisingly, just about all the investment banks are rethinking their strategies. Yet most managers doubt much will be done to cut costs as long as revenues continue to grow. Says Michael Aronstein, formerly a senior investment strategist at Merrill Lynch and now president of Comstock Partners, a money management firm: "It's like those experiments you read about where rats are fed cocaine. They just keep coming back until they're dead."

But if the financial markets turn south, the cost cutting will come with a vengeance. Wall Street's senior managers advanced the hard way, toiling for years before they reached millionaire status, and many of them resent the high-paid youngsters in their firms. Salomon's Gutfreund, for instance, complains that the newest recruits are interested only in money: "When people say that, and view this as a money machine rather than a career that has values and excellence in and of itself, it makes it very hard to run a coherent business." Asked what motivates the Young Turks, he answers: "I can't identify with these folks very well, so I couldn't give you an answer as to what's in those little pointed heads. I don't have a clue."

WINDLE PRIEM, who runs the financial services division at the headhunting firm of Korn/Ferry International, thinks compensation at the investment banks could drop by half in the not-too-distant future, even if there is only a modest slowdown in the business. "It could be a much bigger fall if we have the kind of cycles we had in the bond market in April," he says. A downturn also would likely bring a reordering among the investment banks. Those best positioned to prosper will be the ones with the strongest capital positions, especially those with deep-pocketed parents—Prudential-Bache (Prudential Insurance) and Shearson Lehman (American Express), to name two.

The coming upheaval will not have much impact on Wall Street's customers. Samuel Hayes of Harvard says that corporate borrowers might face higher financing costs if the investment banks became less aggressive. But foreign securities firms, if they escaped the same problems or simply were able to take a longer view, might use the opportunity to buy U.S. market share. Commercial banks, eager to make inroads into the securities business, could follow suit. Individual investors would be little affected—provided, of course, that the securities industry's troubles did not coincide with a market crash. The days when the big firms could cut losses by raising commissions on retail trades, as happened in the late 1970s, are over. Discount brokers would see to that.

How bad could it get? Barring a truly disastrous market like 1973 and 1974, the most likely scenario is the close of an unusually and unhealthily opulent era on Wall Street: fewer stretch limos, a new respect for leanness instead of size, and maybe a little less of the arrogance and condescension that all but the most sensitive investment bankers seem unable to conceal when they meet less highly paid mortals. F

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